

VZCZCXRO1788  
PP RUEHCHI RUEHCN RUEHDT RUEHHM  
DE RUEHJA #1023/01 1440939  
ZNR UUUUU ZZH  
P 230939Z MAY 08  
FM AMEMBASSY JAKARTA  
TO RUEHC/SECSTATE WASHDC PRIORITY 9091  
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS  
RUEHBJ/AMEMBASSY BEIJING 5073  
RUEHBY/AMEMBASSY CANBERRA 2547  
RUEHUL/AMEMBASSY SEOUL 4621  
RUEHKO/AMEMBASSY TOKYO 2013  
RUEHWL/AMEMBASSY WELLINGTON 2677  
RUEAIIA/CIA WASHDC  
RUEHRC/DEPT OF AGRICULTURE USD FAS WASHINGTON DC  
RHEHNSC/NSC WASHDC  
RUEATRS/DEPT OF TREASURY WASHDC  
RUCPDOG/DEPT OF COMMERCE WASHINGTON DC

UNCLAS SECTION 01 OF 02 JAKARTA 001023

SENSITIVE  
SIPDIS

DEPT FOR EAP, EAP/MTS, EAP/MLS  
SINGAPORE FOR SBAKER  
TOKYO FOR MGREWE  
COMMERCE FOR 4430/KELLY  
USDA/FAS/OA YOST, MILLER, JACKSON  
USDA/FAS/OCRA CRIKER, HIGGISTON, RADLER  
USDA/FAS/OGA CHAUDRY, DWYER  
USTR FOR WEISEL, EHLERS  
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR TCURRAN  
DEPARTMENT PASS EXIM BANK  
NSC FOR EPHU

E.O. 12958: N/A  
TAGS: [EAGR](#) [ECON](#) [EFIN](#) [ID](#) [PGOV](#)  
SUBJECT: INDONESIAN CABINET POISED TO RAISE FUEL PRICES

REF: A. A) JAKARTA 1008  
[1](#)B. B) JAKARTA 972  
[1](#)C. C) JAKARTA 943  
[1](#)D. D) JAKARTA 901

[1](#)1. (SBU) Summary: The Cabinet will meet on May 23 to finalize fuel price increase and related pro-poor social spending plans, according to press reports. Although the Government of Indonesia (GOI) has not proposed any specific implementation date for these proposals, officials have stated that the anticipated fuel price increase would average 25-30% and the pro-poor spending would total Rp 40 trillion (\$444 million). With world oil prices soaring, the decision to increase the fuel price reflects concerns that the subsidy bill will exceed 25% of the state budget this year if the GOI does not increase the price of subsidized fuel. The current GOI plan would offset short-term budget concerns but leave the GOI finances vulnerable to further rises in global oil prices. A fuel price increase would exacerbate inflation and is expected to slow GDP growth this year. The GOI is set to implement a series of pro-poor programs to offset the impact of rising fuel prices, including a cash transfer program for 19.1 million poor households. While a similar cash transfer program eased concerns after the 2005 fuel price hike, the current subsidy reduction comes amid rising food prices that have already strained household budgets. End Summary.

Government Fuel Price Hike Imminent  
-----

[1](#)2. (SBU) The Indonesian cabinet is set to meet on May 23 to finalize the details of the planned increase in subsidized fuel prices and pro-poor social spending. The date for actually implementing the fuel price hike remains unknown, although the press and numerous contacts believe it will occur in late May or early June. The projected 2008 budget would result in a Rp 125.3 trillion (\$13.9 billion; Rp 9,000/USD) deficit -- 2.9% of GDP -- if there was no fuel

price increase and the government oil estimate of \$110 per barrel is accurate (ref B). Using the same assumptions, the total fuel and energy subsidy expenditure would reach Rp 265 trillion (\$29.4 billion) this year or almost 25% of the budget, according to GOI officials. The proposed average fuel price hike of 28.7% would reduce the fuel and electricity subsidy bill to Rp 201 trillion (\$22.3 billion). GOI officials repeatedly highlight the regressive nature of the fuel subsidy regime in an effort to align the policy with pro-poor programs; the top 40% of the population receive 66% of the benefit of subsidized fuel prices whereas the poorest 40% receive only 18% of the benefit, according to government contacts. The GOI plan would offset current budget concerns but leave the budget vulnerable to further rises in global oil prices. The plan increases the price cap on subsidized fuel, but fails to introduce a market-based price.

#### Fuel Price Increase Will Exacerbate Inflation

-----

13. (SBU) The proposed reduction in fuel price subsidies would exacerbate inflation, which had already reached 9.0% in April due to rising food costs. The GOI estimates that inflation would rise to 11.2%, significantly higher than the current 6.5% projection, in response to the subsidy reduction. Market analysts expect inflation to rise to 11-15% this year if the GOI increases the price of subsidized fuel by 25-30% and global commodity prices remain high. Most analysts expect the central bank to respond by raising interest rates by as much as 100-200 basis points by the end of the year, although political pressure to limit the impact of higher interest

JAKARTA 00001023 002 OF 002

rates on economic growth will be strong in advance of the election (ref D). Aggressive monetary tightening this year will slow growth prospects in 2008 and into 2009. The official economic growth estimate for 2008 would slip to 6.0% after the proposed fuel price hike, down from the current 6.5% projection, according to the GOI.

#### Cash Transfer Program Ready for Implementation

-----

14. (SBU) The GOI plans on allocating Rp 40 trillion (\$4.4 billion) of the fuel subsidy savings for pro-poor social programs, according to press reports. Within this plan, the GOI is set to implement a cash transfer program for poor households to offset the impact of rising fuel prices, aiding Indonesia's poorest families but leaving the near poor and lower middle class vulnerable. The proposed cash transfer program would provide 19.1 million poor households (an estimated 76.4 million people) with Rp 100,000 (\$11) per month for seven months beginning in June. The program would cost Rp 14.2 trillion (\$1.6 billion), according to GOI estimates. Finance Minister Sri Mulyani Indrawati said that the GOI would also propose to include this cash transfer program in next year's budget, according to press reports. While a similar cash transfer program eased concerns about the 2005 fuel price hike, the current subsidy reduction comes in the wake of rising food prices that have already strained household budgets. The estimated 25 million people that live near the poverty line but do not qualify for the cash transfer program have already faced household budget pressure from rising food prices and are likely to feel the largest impact of the fuel price hike. The Indonesian National Police are concerned that the fuel price hike will lead to larger, more raucous demonstrations throughout the country but they do not think the demonstrations will cause serious problems.

HEFFERN